No. 20645

United States Court of Appeals

FOR THE NINTH CIRCUIT

THE INTERPUBLIC GROUP OF COMPANIES, INC., a corporation,
McCANN-ERICKSON, INC., a corporation, and
INTERPUBLIC INC., a corporation,

Appellants,

vs.

ON MARK ENGINEERING CO., a corporation, and
SECURITY FIRST NATIONAL BANK,

Appellees.

OPENING BRIEF OF APPELLANTS
The Interpublic Group of Companies, Inc., A Corporation, McCann-Erickson, Inc., A Corporation, and Interpublic Inc., A Corporation.

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JURISDICTIONAL STATEMENT

Jurisdiction of the United States District Court to entertain this action was founded upon diversity of citizenship between the parties pursuant to Title 28 U.S.C. Sec. 1332(a)(1).

Appellee On Mark Engineering Co. (hereinafter referred to as "On Mark"), a California corporation, sued to recover rental payments alleged to be due it under a written lease and option to purchase entered into with appellant The Interpublic Group of Companies, Inc., a

Delaware corporation (hereinafter referred to as "Interpublic"). Interpublic was sued under its former name of McCann-Erickson Incorporated and is generally referred to in the findings as "McCann."[1] Appellants McCann-Erickson, Inc., a Delaware corporation, and Interpublic Inc., a New Jersey corporation, subsidiaries of The Interpublic Group of Companies, Inc., were also joined as defendants by On Mark.[2]

Security First National Bank (hereinafter referred to as "Security Bank"), a national banking association and an assignee from On Mark of the said lease and option agreements, was permitted to intervene under Rule 24 of the Federal Rules of Civil Procedure to assert its claim as assignee.

The amount in controversy exceeded $10,000. [Fndg. 5, Clk. Tr. 162.]

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[1] It was stipulated by the parties that appellant The Interpublic Group of Companies, Inc. was originally incorporated in Delaware in 1930 under the name McCann-Erickson Incorporated; that on December 30, 1960, it changed its name to Interpublic Incorporated; and that on January 8, 1964, it again changed its name to The Interpublic Group of Companies, Inc., and that this is now the name of the corporate entity which actually entered into the lease and option agreements with On Mark. It was further stipulated that appellant Interpublic, then known as McCann-Erickson Incorporated, executed the lease and option agreement in question under the name of "McCann-Erickson, Inc. [Clk. Tr. 180]

[2] The parties further agreed that any judgment which the District Court might enter in the case in favor of plaintiff and against any one defendant would also be a judgment against, and be binding upon, each and all of the defendants. [Fndg. 4, Clk. Tr. 161.]

This Court has jurisdiction of the appeal from the judgment of the court below pursuant to Title 18 U.S.C. Secs. 1291 and 1294.

STATEMENT OF THE CASE

On July 10, 1959, appellee On Mark and appellant Interpublic executed two writings pertaining to a certain Douglas A-26 type aircraft owned by On Mark. The plane had been built as a military aircraft but was to be converted by On Mark for use by Interpublic as an "executive" aircraft. [Fndg. 6, Clk. Tr. 162.]

The two writings, one entitled "Lease Agreement" and the second "Option to Purchase Aircraft," were executed concurrently and were intended by the parties to be taken together and to constitute one single entire agreement between them. [Fndg. 7, Clk. Tr. 162.]

The term of the lease was 60 months, and the monthly rental was $7,747. A total rental of $464,820 was thus payable if the lease continued for the full term. [Fndg. 9(b), Clk.Tr. 163.] The monthly rental payments for the first two and the last three months of the term were payable by Interpublic to On Mark at the time of execution of the lease. Thereafter, monthly rental payments were to be made beginning on a date two months after the date of delivery of the aircraft to Interpublic "and monthly thereafter on the day of the month said delivery shall have been made, until three months prior to the end of the term hereof. . . ." [Pltf's Ex. 2, par. 1-B.]

The lease further provided that On Mark was to make the aircraft available at its plant, for the lessee's flight

test acceptance, no later than October 14, 1959. Delivery of the aircraft was to take place at the said plant no later than October 24, 1959. [Pltf's Ex. 2, par. 2 fn.] On Mark would not, however, be in default if prevented from meeting this schedule by factors beyond its control, so long as it used its best efforts. [Pltf's Ex. 4.]

The option agreement provided that Interpublic should have the option to purchase the plane at a price of $32,950, said option to be exercised and delivery of the aircraft to be made to Interpublic "between July 15, 1964 and August 15, 1964." Interpublic was required to give On Mark fifteen days' prior written notice of its intention to exercise this option. [Pltf's Ex. 3.]

On Mark did not complete its conversion work by mid-October 1959, and delivery to Interpublic did not finally take place until December 18, 1959. [Fndg. 10, Clk. Tr. 164.] Thereafter, and until June 28, 1962, the aircraft continued in the possession of Interpublic, which made monthly rental payments on the 18th day of each month.

On February 8, 1960, On Mark executed and delivered to Security Bank a promissory note in the principal amount of $375,000, and concurrently therewith, as security for the note, On Mark executed and delivered to Security Bank a chattel mortgage on the A-26 aircraft and an assignment of the moneys payable by Interpublic to On Mark under the written lease and option. [Fndg. 31, Clk. Tr. 172; Pltf's Ex. 9.] At the request of On Mark and Security Bank, Interpublic gave its written consent to the said assignment. The written consent provided that Interpublic would pay directly to the Security Bank

all sums payable under the lease or option and further provided that Interpublic would not terminate the lease without the written consent of the assignee. [Pltf's Ex. 9.] After obtaining the assignment and consent thereto, Security Bank released certain third-party guarantors who had previously guaranteed payment of the bank's loan to On Mark, but it was admitted that the existence of this prior guarantee and the subsequent release of the guarantors were never communicated to Interpublic. [Rep. Tr. 1752, line 20 — 1753, line 8.]

On June 28, 1962, the aircraft was involved in an accident at an airport in Elkhart, Indiana, and sustained substantial damage. Following the accident at Elkhart, On Mark had the plane disassembled and shipped to its plant in Van Nuys, California. [Fndg. 13, Clk. Tr. 165.] Inspection of the aircraft and conferences with insurer's representatives ensued and on November 27, 1962, On Mark commenced repairs on the aircraft. [Fndg. 19, Clk. Tr. 168.] On Mark advised Interpublic by letter dated February 14, 1963, that the repairs would be completed and the aircraft ready for redelivery by February 22, 1963. [Fndg. 19, Clk. Tr. 168.] Interpublic declined to accept redelivery on the ground that On Mark had not lived up to its obligations under the lease with respect to repair of the aircraft. [Pltf's Ex. 72.]

On Mark's first amended complaint, filed in May 1963, alleged breach of the written lease agreement by Interpublic and sought damages in the amount of $7,747 per month for a period of twenty-five months, this being the period of time after February 23, 1963 which On Mark contended the lease term still had to run in order to pro-

vide On Mark with a full 60-months' rental. On Mark also sought recovery of $1500 per month as costs of maintaining, storing and flying the aircraft to keep it in an airworthy condition.

After the answer of the subsidiary corporations McCann-Erickson, Inc. and Interpublic Inc. had been filed, but prior to the filing of the answer of The Interpublic Group of Companies, Inc., Security Bank moved to intervene in the action, and this motion was granted on December 9, 1963. By its complaint in intervention, Security Bank also alleged breach by Interpublic of the written lease agreement and sought recovery of unpaid accrued rentals pursuant to the assignment. It also prayed for declaratory relief as to whether or not Interpublic would be barred from exercising any rights under the option. [Clk. Tr. 29.]

Appellant Interpublic answered the amended complaint of On Mark and the complaint in intervention of Security Bank, denying in both answers any liability for alleged breach of the lease and asserting that by its failure to repair the damaged aircraft promptly and properly, On Mark had excused Interpublic from further performance of any obligations it might previously have had under the said lease. [Clk. Tr. 12.]

On June 30, 1964, Interpublic gave written notice to On Mark that it intended to exercise its option to purchase the aircraft on July 15, 1964 upon the payment of the option price of $32,950. [Fndg. 30, Clk. Tr. 171] On July 2, 1964, On Mark sent a written reply, taking the position that Interpublic was in default under the

lease and therefore had no right to exercise the option. [Clk. Tr. 130, par. 9.]

At the trial the bulk of the evidence related to the issue of whether the airplane had been promptly and properly repaired. Plaintiff also offered, and the court received over defendants' objection, evidence of the negotiations between the parties preceding the execution of the lease and option. [Rep. Tr. 227 - 273; 800 - 816; and 895 - 918.] On Mark's counsel informed the court that the purpose of this testimony was to show that although the transaction took the form of a lease and option to purchase, the parties looked upon the transaction as a purchase and sale; Interpublic was, therefore, entitled to exercise the option, not between the dates of July 15 and August 15, 1964, as expressly stated therein, but rather only after paying a full 60-months' rental. [Rep. Tr. 236, lines 6-19; 238, lines 10-15, 17-22; 246, line 21-247, line 8; 247, lines 11-13.]

Appellants' counsel objected several times to this testimony at the trial, on the ground that it was offered for the purpose of varying the express terms of the written option agreement which specified definite dates for its exercise and made no provision for postponement. [Rep. Tr. 224, line 15-226, line 17; 233, line 23; 244, line 16.]

The trial court concluded, however, that the lease and option contained ambiguities and that parol evidence was therefore admissible to determine the intent and true agreement of the parties concerning the exercise of the option. [Con.L. 3, Clk. Tr. 173.] On this issue the court found from the parol evidence admitted for this purpose that the option was exercisable only during the period

test acceptance, no later than October 14, 1959. Delivery of the aircraft was to take place at the said plant no later than October 24, 1959. [Pltf's Ex. 2, par. 2 fn.] On Mark would not, however, be in default if prevented from meeting this schedule by factors beyond its control, so long as it used its best efforts. [Pltf's Ex. 4.]

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commencing with the 26th day of January and ending with the 26th day of February, 1965, and that Interpublic had not been entitled to exercise its option on July 15, 1964. [Fndg. 30, Clk. Tr. 171.]

On the issues as to the sufficiency and timeliness of the repairs the court found that the aircraft had been properly and adequately repaired [Fndg. 24, Clk. Tr. 169], and that On Mark did "promptly" execute said repairs, considering all of the circumstances attendant to such repairs. [Fndg. 23, Clk. Tr. 169.] The court also concluded that in any event Interpublic had waived all rights which it may have had to object to either the time utilized for making the repairs or to the nature, scope or adequacy of the repairs which were made to the aircraft. [Con.L. 8, Clk. Tr. 174.]

On the basis of the above findings the court concluded that Interpublic was still obligated under the lease to pay rentals for a full 60 months, this being the total sum of $201,422, representing rent accrued from February 27, 1963 through April 26, 1965, with interest on unpaid payments at 7%. Of this total amount, the sum of $118,857.10, with interest, was to be paid to Security Bank, representing the amount still owing by On Mark to Security Bank pursuant to assignment. [Con.L. 14 and 15, Clk. Tr. 175.]

The court also held On Mark entitled to recover $10,891.90, representing the cost to On Mark of maintaining and storing the plane during the period from March 1, 1963 to December 31, 1964. [Con.L. 16, Clk. Tr. 176.]

The court held that Security Bank had acted to its detriment in releasing the third-party guarantors of its loan to On Mark, and that this constituted consideration sufficient to make Interpublic's consent to the assignment a binding agreement. The court further held that Interpublic was estopped to deny its promise not to "terminate" the lease without the consent of the Bank. [Con.L. 11 and 12, Clk. Tr. 175.]

Accordingly, the court gave judgment for On Mark and Security Bank on their respective amended complaint and complaint in intervention. [Clk. Tr. 182.] The judgment further provided that appellants might, within thirty days after entry of judgment, elect to exercise the option to purchase the aircraft, provided that they pay the option price of $32,950 plus an additional sum of $9,047.27, representing the cost of a reinforcing "strap" which had been installed on the said aircraft. [Clk. Tr. 183.]

On this appeal the appellants are not attacking the trial court's findings that the aircraft was repaired properly and within a reasonable time. There was conflicting evidence as to whether or not the plane was properly repaired, and the trial court's findings in this respect find substantial support in the evidence.

Appellants do assert that the trial court's judgment was erroneous insofar as it was based on a conclusion that the option to purchase the aircraft was not exercisable until the period commencing on January 26, 1965, contrary to the express provisions of the written option, and that, proceeding on this erroneous conclusion, the trial court awarded judgments far in excess of any damage shown.

SPECIFICATION OF ERRORS

1. The District Court erred in holding that the express terms of the written option agreement between the parties might be varied by parol evidence, the purpose of which was to show that the agreement between the parties did not permit exercise by Interpublic of the option to purchase the aircraft until January 1965, rather than between July 15 and August 15, 1964, as expressly stated therein.

2. The District Court's finding that it was the intent and true agreement of the parties that the option to purchase the aircraft was not to be exercised between July 15, 1964 and August 15, 1964, but rather in January and February 1965, is clearly erroneous and without support from the evidence.

3. The court erroneously permitted recovery of lease rentals and costs of maintenance, repair and modifications for a period beyond the time the option was exercisable and exercised in accordance with its terms.

4. The court erroneously failed to determine the value of the option as an offset against plaintiff's right to recover rent and failed to give it any effect as an offset, thereby permitting plaintiff to recover damages in excess of what it would have received by full performance.

5. The court erroneously held that plaintiff in intervention acquired rights in excess of those of plaintiff, its assignor.

SUMMARY OF ARGUMENT

The trial court erroneously received evidence of negotiations between the parties preceding the execution of the lease option agreement, the stated purpose of which evidence was to show that the parties looked upon the transaction as a simple sale of the aircraft. On the basis of this evidence, which did not in any event support any such conclusion, the court determined that appellants were not entitled to exercise the option to purchase between July 15 and August 15, 1964, as expressly stated in the agreement, but rather only in January or February 1965, after paying a full 60-months' rent.

Proceeding on this erroneous premise, the court permitted appellees to recover damages far in excess of the benefits which they would have received had the contract, properly construed, been fully performed on both sides. Recovery was allowed for rental for a period beyond the date when the rental obligation was subject to being extinguished by exercise of the option. Likewise, appellants were allowed no credit for the considerable value of the option, which was at a price far below the value of the plane when it was exercisable.

When proper consideration is given to the reduction of On Mark's claim on the above bases, the amount due it is less than the judgment rendered in favor of appellee Bank. Appellee Bank had no rights transcending the extinguishment of the lease by exercise of the option. The judgment in its favor must, therefore, be reduced to the amount which its assignor, appellee On Mark, is entitled to receive.

would have been made,[3] (3) the lease further provided for extension of the lease term if necessary due to the term not commencing when anticipated, or if, due to accident requiring repairs, an extension was necessary in order to preserve the 60-month rental period, and (4) the option agreement provided for exercise between specific dates of July 15 and August 15, 1964. [Op., Clk. Tr. 154.]

The court thus in effect decided that the lease option agreement was ambiguous because the exercise of the option on the date specified would result in a reduction of the total 60-months rent if the lease were extended to a time more than three months beyond the option date specified, and the lessee exercised its option.

However, leases of real and personal property frequently contain provisions giving the lessee the option to purchase the property at a time which may be prior to the end of the lease term. The rule is that the exercise of such an option operates to cut off the lessor's right to continued rental payments because it extinguishes the lease, unless the lease contains an express stipulation to the contrary. There can therefore be no inconsistency between any provision stating the term of the lease and

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3 It is significant that the discussion of this question in the opinion of the court does not refer to this alleged fact. It is, of course, in any event irrelevant what the parties "originally anticipated." If extrinsic evidence were admissible it would only be to show the contemplation of the parties at the time the contract was executed. That contemplation, as demonstrated *infra,* pages 27-28, by the admission of plaintiff's president, was that the airplane would not normally be ready for delivery until December 1959, and not in October.

a provision granting an option to purchase at a time which may come before the end of such term and thereby extinguish the hiring. The rule assumes the existence of a term which is thus extinguished.

California law recognizes that the effect of a conveyance by the lessor of his interest in the leased property to the lessee is to merge the leasehold estate into the larger estate granted. The result of such merger is the extinguishment of the lessee's obligation to continue to pay rent.

This principle is stated in Section 1933 of the California Civil Code, as follows:

> "The hiring of a thing terminates:
>
> " . . .
>
> "3. By the hirer acquiring a title to the thing hired superior to that of the letter;"

Sacks v. Hayes, 146 Cal.App.2d Supp. 885 (1956), was an action for rental payments alleged to be due to plaintiff lessor from defendant lessee. The evidence showed that the lease of the premises in question was for a period of fourteen months, from September 1955 through October 1956, and that the lessee had paid, in advance, the $125 monthly rental for the first month and last two months of the term. In October 1955, however, the lessee gave notice of her intention to exercise an option to purchase provided for by the lease agreement, and she did not make further rental payments. In reversing a judgment for the plaintiff, the court quoted with approval from the Illinois case of *Cities Service Oil*

Company v. Viering, 89 N.E.2d 392 (Ill. 1949), as follows, at pages 887-888:

> ". . . 'Where the relation of landlord and tenant exists under the terms of a written lease, containing an option to purchase which the lessee exercises, he is no longer in possession as a tenant, but his possession is that of a vendee. . . . The lessor is not entitled to rent after the option to purchase is exercised *unless there is in the lease an express stipulation therefor.* 51 C.J.S., Landlord and Tenant, § 82a. The exercise of the option extinguishes the lease and terminates the relation of landlord and tenant. The lease and all its incidents, express and implied, are blotted out of existence, and the relation of vendor and vendee created." (Emphasis added.)

In accord, see:

Peebler v. Seawell, 122 Cal.App.2d 503 (1954);

Murfee v. Porter, 96 Cal.App.2d 9 (1950).

The lease option agreement between On Mark and Interpublic does not contain any express stipulation for payment of the full 60 months' rent in the event the option is exercised before the expiration of the 60-month term. There is only a flat statement that the option is exercisable between July 15 and August 15, 1964, upon fifteen (15) days' prior written notice. The legal effect, therefore, of the agreement was to extinguish the obligation to pay rent if the option was exercised during such period by due notice.

On Mark's real purpose in introducing evidence of the prior negotiations between the parties was not to explain or interpret the option agreement but to contradict its plain terms and legal effect by showing that it could not be exercised so as to extinguish the rental obligation. It was not proper to permit On Mark to do this.

> "It is a fundamental rule, with only a few exceptions, that extrinsic evidence of prior or contemporaneous negotiations, agreements, declarations or warranties is not admissible to add to, contradict, vary, or, in the absence of an ambiguity, even to explain the terms of a written instrument *or to change its legal effect.*" 18 Cal.Jur.2d 737. (Emphasis added.)

California courts have always been particularly stringent in enforcing all aspects of this rule with relation to the time of performance of written contracts. Where the legal effect of failure to specify a time of performance is to require performance within a "reasonable time," evidence of prior negotiations is inadmissible to vary such legal effect. Where a specific date for performance is stated, such negotiations are inadmissible to show a different date.

In *Standard Box Co. v. Mutual Biscuit Co.,* 10 Cal. App. 746 (1909), an option contained no provision specifying the time for exercise thereof. The court held inadmissible parol evidence to show that the option was exercisable within one year and was not limited to a reasonable time. The court said, pages 750-751:

> "Nor do we think it was competent to show by parol testimony that at the time the option was given

plaintiff agreed that defendant should have one year within which to accept it. It is a well-settled principle that that which is implied by law becomes as much a part of the contract as that which is therein written, and if the contract is clear and complete when aided by that which is imported into it by legal implication, it cannot be contradicted by parol in respect of that which is implied any more than in respect of that which is written. In the present case the law required that the acceptance should be communicated to plaintiff within a reasonable time, and this reasonable time could not be extended by parol. . . . "

California D. & M. Co .v. Crowder, 58 Cal.App. 529 (1922), held that where a written contract to furnish the material and drill certain wells was silent as to the time when the work was to be finished, a reasonable time was allowable under Section 1657 of the Civil Code, and parol evidence was not admissible to show a collateral oral agreement that the work was to be completed by a specified date.

The foregoing cases are illustrations of the general rule that terms of a written contract which are implied by law are as impervious to parol evidence as are the express terms.

Other cases so holding are:

Taylor v. Continental Southern Corp., 131 Cal.App. 2d 267 (1955);

Calpetro Producers Syndicate v. C. M. Woods Co., 206 Cal. 246 (1929).

Specific dates for performance stated in a written contract are universally held inviolate.

In *Buffalo Arms, Inc. v. Remler Co.,* 179 Cal.App.2d 700 (1960), an action by the seller of goods to collect the purchase price, the written agreement between the parties provided that the goods were to be shipped to the buyer on a 30-day trial basis, and that the buyer was to return the goods if it decided, at the end of the 30-day period, that it did not wish to buy. After the goods had been received, the buyer retained them for 103 days before notifying the seller that the goods were unsuitable for its needs. On appeal from the granting of a summary judgment in favor of the seller, the buyer claimed that a triable issue had been presented in its affidavits, which contained recitations of conversations between the parties showing an intention not to require the buyer to decide within the 30-day trial period whether to keep the goods. The court held that the parol evidence rule would forbid the introduction of such evidence, saying at page 710:

> " 'The rule that prior or contemporaneous negotiations cannot be used to contradict, add to or vary a written contract, applies not only to the letter of the written document, but also to its legal effect.' (Citing cases.) What defendant seeks is not to interpret or explain its letter, but to contradict its plain terms and legal effect. The alleged agreement stated in defendant's affidavit was necessarily oral, as it is admitted that there was no other writing. It is clearly inconsistent with the express requirement that the defendant was to decide against the purchase within a reasonable time after the 30-day

Mr. Denny's testimony was to the effect that initial negotiations related to Interpublic's interest in "acquiring" an airplane, that a "possible purchase or lease" was discussed with Mr. Harder as representative of Interpublic, it being indicated that Mr. Harder's company would operate the plane for Interpublic. Detailed specifications were discussed, and at one time a sale price of approximately $400,000 was quoted. This was later reduced to $385,000, which Harder agreed was reasonable. Harder then requested a firm quotation on a 60-month lease basis, explaining that Interpublic did not desire to make the substantial cash outlay for purchase and that it would be more advantageous from a tax point of view to "do it on a lease basis with an option to purchase." [Rep. Tr. 240.] Denny indicated acceptance of the lease option approach so long as it would mean substantially the same financial result as a sale. About this time On Mark sent a telegram, Plaintiff's Exhibit 1, in which a sale at $385,000 or a lease option proposal as an alternative were submitted. Thereafter On Mark prepared the lease option documents providing for a rental of $7,747 per month, which was determined upon by On Mark. Since it had not been in the business of leasing aircraft, On Mark consulted with a leasing company and obtained a formula to apply to the $385,000 purchase price for a 60-month lease with option to purchase. This formula indicated 2¼% per month rent and an option at the end at 8% to 10% of the original value. [Rep. Tr. 251.] Mr. Denny further testified that the airplane was custom-made to Interpublic's specifications, which constituted "an unusually complete and expensive package" [Rep. Tr. 254], and that Mr. Harder spent

considerable time supervising the completion of the plane to specifications as the work progressed.

Mr. Denny referred to Plaintiff's Exhibit 4, a July 13, 1959 letter modifying the delivery requirements so as to excuse On Mark if delivery did not occur by October 15, 1959, by reason of occurrences beyond its control, so long as it was using its best efforts. He explained that this modification was obtained because On Mark knew that "the original October date was pretty tight," and he further stated that "the main reason the airplane was not delivered until December 1959" was that it had to depend on many vendors to supply component parts, which were late in arriving. [Rep. Tr. 259.] Mr. Denny indicated that the approximate cost of the airplane to On Mark was $375,000, which it borrowed from the Bank [Rep. Tr. 266]. Finally, Mr. Denny explained that before specifically proposing the rental and option terms, On Mark's secretary-treasurer prepared an amortization schedule to see whether or not On Mark would be as well off with a lease option on the formula provided by the leasing company as it would be with a sale. This having been done, Denny advised Interpublic, through Mr. Harder, that the monthly rental on a 60-month lease would be $7,747 per month and that the option purchase price at the end of the lease would be $32,950. [Rep. Tr. 272.] Harder indicated he would recommend approval, and the documents were prepared by On Mark.

Mr. Harper's testimony, given in deposition, was also offered by plaintiff. Harper's testimony was to the effect that he discussed the acquisition of the plane with Denny, who mentioned a price of $405,000, and that he, Harper,

stated that that was too much of a capital outlay and the possibility of a lease should be explored. Harper indicated that to be practical the lease would have to entail a right to purchase the aircraft "at the end." [Rep. Tr. 802 - 803.] Harper did not know how the rental of $7,747 was determined [Rep. Tr. 810], but recalled that the lease term had always been discussed in terms of five years or 60 months.

John Harder's testimony concerning his participation in the negotiations was to the effect that he told On Mark he represented parties "interested in acquiring" the airplane [Rep. Tr. 895]; that initially the conversation related to an investigation of the cost, assuming various specifications, as a result of which a preliminary estimate or budget of over $400,000 was generated. There followed discussions of a lease "as opposed to outright sale" between Harder and the On Mark executives. [Rep. Tr. 902.] These discussions resulted in the telegram, Plaintiff's Exhibit 1, offering a lease option as an alternative to a purchase at a price of $385,000, which had by that time been arrived at as the approximate cost. Though Harder advised Interpublic what it would cost to buy the plane, he did not propose any outright purchase. [Rep. Tr. 904.]

In early July Harder advised On Mark that he thought it would be possible to consummate a lease and participated in the final settlement of the specifications, which he approved. [Rep. Tr. 910.] These negotiations were progressing as the final form of the lease option documents was being worked out.

The above evidence in no respect supported the finding that the option was not exercisable until sometime be-

tween January 26 and February 26, 1965, when the option agreement specifically provided that it might be exercised between July 15 and August 15, 1964. The substance of the testimony was that for several weeks or months prior to the execution of the documents the parties negotiated with respect to the "acquisition" of the aircraft, either by purchase or on a lease option basis; that the terms offered for an outright purchase amounted to $385,000; and that the lease option arrangement was an alternative to such outright purchase. On Mark's telegram, Plaintiff's Exhibit 1, specifically so states. To be sure, the initial discussion involved On Mark's stated position that a lease would be acceptable, provided it was on terms which would result in On Mark being "substantially financially rewarded in the same manner as a sale." This, of course, meant no more than that On Mark would require lease terms which it considered equally advantageous financially as a sale at $385,000. The initial discussions also apparently involved a general statement on the part of Interpublic's president, Mr. Harper, that if there were a lease he would have to have an option to purchase the aircraft "at the end."

Such vague generalities voiced at the inception of the negotiation certainly cannot serve to vary specific terms of the lease option agreement prepared by On Mark and submitted many weeks later. In the meantime, On Mark had initiated its own inquiry of a leasing company to determine a formula for establishing lease and option terms. It did not discuss this formula with Interpublic. On Mark simply decided what lease terms it considered would be financially equal to a purchase and sale at $385,000, prepared a definitive draft contract setting

forth the rental term and rate, the date and price for exercise of the option, and all other conditions which it considered would result in such equality, and submitted the contract to Interpublic. The final contract as amended was a complicated, technical lease option agreement which specifically provided that ownership and risk of loss of the aircraft would remain with On Mark, Interpublic as lessee being obligated to procure hull insurance for On Mark's benefit. [Pltf's Ex. 2, par. 5.] Interpublic was required to return the aircraft to On Mark "at the termination of this lease" [Pltf's Ex. 2, par. 8], unless, of course, the option to purchase was exercised. The lease and option together comprised eight pages, and included numerous conditions involving considerable expense for the lessee, such as the obligations to maintain the aircraft, to insure it and to pay taxes levied against it. All of these conditions bore materially upon the relative financial advantage of a sale or a lease on such terms. It would be impossible to relate the generalities exchanged in the initial general discussion to the situation presented by the final settlement of the terms of such an agreement.

Confronted with the obvious fact that general statements made in preliminary discussions many weeks previous could not establish intent at the time of the execution of the definitive conrtact, counsel for On Mark attempted by argument to demonstrate that at the time of execution the parties intended the option was to be exercised only after the payment of 60-months' rent. The explanation was as follows: The lease and option agreement was executed on July 10, 1959. At that time it was contemplated that delivery of the aircraft was to be made to Interpublic approximately three (3) months

later, viz., on October 14, 1959, the date specified for delivery in the lease itself. At the time of execution of the agreements, the last three (3) months' rent was paid in advance. Therefore, the argument runs, fifty-seven (57) additional months remained to be paid, and fifty-seven (57) months beyond October 15, 1959 would be July 15, 1964, the date when the option could be exercised. By that time 60-months' rent would have been paid and the lease term would end. The parties therefore inserted the dates July 15 to August 15 in the option agreement.

This explanation, which apparently was found persuasive by the court [Fndg. 9(c), Clk. Tr. 163], is demonstrably fallacious. It is directly contrary to the uncontradicted admission in the testimony of Robert O. Denny, President of On Mark, who, at the taking of his deposition, read into evidence at the trial [Rep. Tr. 406, line 11-407, line 1], unequivocally stated that at the time the lease and option agreements were executed in July of 1959, it was *not* contemplated that delivery of the aircraft could be made by mid-October. It could not, therefore, have been contemplated that On Mark was to have 60-months' rent under any and all circumstances, or even that it was likely under any circumstances to receive any such rental payment. Denny's testimony was as follows:

> "Q At the time that the lease and option were signed in July when was it estimated that the aircraft would be ready for delivery to Interpublic?
>
> "A Normally it takes us approximately five months to do the work that had to be accomplished

between the time of commencing work and delivery of the aircraft.

"Q The term of the lease, then, was to start from the date of the delivery, isn't that correct?

"A Yes, I believe that is correct.

"Q Which would make it, then, about December of 1959?

"A That is correct.

"Q Do you recall so testifying, Mr. Denny?

"A Yes, sir."

Obviously, only fifty-eight (58) months' rental would have been paid by the option date if delivery were in December, as contemplated.

Mr. Denny further admitted [Rep. Tr. 259] "the original October date was pretty tight, we knew that." As a result, he had a conversation with Mr. B. F. Holme, Jr., then Secretary of Interpublic, with respect to the October 14 delivery date and other matters inserted by interlineation in the lease agreement. [Rep. Tr. 403, line 1-405, line 9.] Following that conversation, Mr. Holme sent On Mark a letter (Pltf's Ex. 4) confirming the agreement of the parties that with respect to the delivery date On Mark would use all reasonable efforts to make the aircraft available for flight test by October 14, 1959 and to make final delivery on or before October 24, 1959; but that if occurrences beyond On Mark's control should make such delivery impossible, then On Mark would use its best efforts to make final delivery at the earliest possible date thereafter.

Mr. Denny testified that he negotiated this modification of the lease with regard to the delivery date so that On Mark would not be in default by reason of a delay in delivery beyond October 14, 1959. [Rep. Tr. 405, lines 6-9.] He succeeded in obtaining such protection and when, as he expected, late receipt of component parts delayed completion [Rep. Tr. 259], Interpublic accepted late delivery. He admittedly did not, however, ask that provision be made to postpone the option date, as he would have done had he intended not only to avoid default but as well to preserve the right to a full 60-months' rental.

Similarly, On Mark submitted the lease with a provision obligating it to repair damage to the aircraft "promptly" if it elected to continue the lease [Pltf's Ex. 2, par. 5] and extending the term for the period taken for such repairs "so that the lessee's possession of said aircraft shall cover 60 full months." Though it must have been obvious that this could result in the term extending many more than three months beyond the option date, On Mark simultaneously and as part of a single agreement submitted a form of option with fixed dates for its exercise.

As demonstrated above, On Mark must be presumed to have intended the legal effect which the agreement it proposed carried. That legal effect was that the exercise of the option between the dates fixed therefor extinguished all obligation under the lease. The consequence of delayed delivery, or of damage requiring repair which took a substantial time to accomplish, all were readily apparent and must certainly have been taken

into account by On Mark in evaluating the lease option arrangement as the equivalent of a sale for $385,000.[4]

Under the lease terms title and risk of loss remained in On Mark at all times. [Pltf's Ex. 2.] If the aircraft suffered substantial damage, it would of course, even though repaired, not be worth as much as it would be if it suffered no damage. Interpublic would also have undergone the expense of hiring other aircraft while the repairs were being made, as it in fact did. [Pltf's Ex. 22.] Consequently, if On Mark were to sell the damaged and repaired aircraft to Interpublic for the option price, but without having received as many months' rental as originally hoped for, there would be no injustice to either side. It was, therefore, perfectly reasonable to provide a fixed date for the exercise of the option.

The District Court's finding that it was the intention of the parties that the option not be exercised before Interpublic had paid a full 60 months is, therefore, clearly erroneous. No evidence supports it, and the uncontradicted evidence in the form of admissions in the testimony of On Mark's president and the documents submitted by On Mark flatly contradict it.

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[4] It must be borne in mind in this connection that if the entire 60-months' rental had been paid together with the $32,950 option price, On Mark would have received over $497,000 for the airplane which it was willing to sell for $385,000.

III. THE TRIAL COURT ERRONEOUSLY PERMITTED RECOVERY OF RENT AND MAINTENANCE COSTS FOR A PERIOD BEYOND THE OPTION DATE.

Having improperly found that the option was not exercisable until January 26, 1965, the trial court awarded damages far in excess of the benefits which would have been received by appellees had the contract, properly construed, been fully performed on both sides. One way in which this resulted was that the trial court held that On Mark was entitled to judgment against appellants in the sum of $201,422.00, representing the rentals accruing and payable but unpaid from February 27, 1963 through April 26, 1965, together with interest. [Con. L. 15, Clk. Tr. 175.][5]

The court also held On Mark entitled to judgment against appellants for the sum of $10,891.90, representing costs incurred by On Mark in maintaining, operating and storing the aircraft during the period from March 1, 1963 to December 31, 1964. [Con. L. 16, Clk. Tr. 176.]

The action of the court in allowing recovery of the rental and maintenance costs beyond the date when Interpublic's attempt to exercise the option would have been effective violates two well established principles of law: (1) The rule that no person shall be allowed to recover a greater amount in damages for the breach of an obligation of a contract than he could have gained by full

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[5] The only reduction provided was the sum to be paid by Interpublic to Security Bank pursuant to the judgment, $118,857.10, with interest. [Con. L. 14, Clk. Tr. 175.]

performance thereof on both sides, and (2) the previously noted rule that the exercise of an option by the lessee merges the leasehold estate and extinguishes the lessee's obligation to continue to pay rent.

A. Damages For Breach of Contract May Not Exceed That Which The Obligee Could Have Gained By Full Performance On Both Sides.

Section 3358 of the Civil Code of the State of California provides as follows:

> "Notwithstanding the provisions of this chapter, *no person can recover a greater amount in damages for the breach of an obligation than he could have gained by the full performance thereof on both sides,* except in the cases specified in the articles on exemplary damages and penal damages, and in sections three thousand three hundred and nineteen, three thousand three hundred and thirty-nine, and three thousand three hundred and forty." (Emphasis added.)

The particular aspect of this rule applicable to prevent the recovery of rent beyond the option date is that which denies damages on account of any continuing obligation which may be extinguished by notice or other act of the obligor. It is patent that if Interpublic had accepted the return of the aircraft and had continued to make the monthly payments until July 15, 1964, it was entitled to extinguish any further obligation to pay rent by its exercise of the option. The exercise of the option involved no burden on the part of Interpublic, since as demonstrated *infra,* Part IV, the airplane was worth almost

four times the option price. On Mark would not, therefore, have received any rental payments beyond the July, 1964 option date. Consequently, it may not recover damages based upon any rental that would have thereafter been payable. Likewise, On Mark would have no occasion to incur any costs of maintenance or operation of a plane in Interpublic's behalf. Interpublic would be in possession of the plane if On Mark did not repudiate the option. Having repudiated any further obligation under the option because of Interpublic's default, On Mark maintained the plane in its own behalf.

Numerous cases hold that the proper measure of damages for breach of a contract by one holding a power to terminate that contract by giving notice is the injured party's loss of profit for the specified notice period only.

The principle is stated in Volume 25, Corpus Juris Secundum, Damages § 74, page 853, as follows:

> "Where notice to terminate is given as authorized by the contract, recovery may be limited to profits which would have been made between the time of the notice of cancellation and the effective date thereof." (Citing *Spur Bottling Co. v. Canada Dry Ginger Ale,* 98 F.Supp. 972 (W.D. Ark. 1951).)

Among the cases which have applied this principle is *Chevrolet Motor Co. v. McCullough Motor Co.,* 6 F.2d 212 (9th Cir. 1925). The case involved an automobile dealer franchise, terminable by Chevrolet upon giving five days' notice to the dealer. Chevrolet repudiated the contract without giving the required notice, and the court considered the question of whether a recovery of

damages might be had against Chevrolet, measured by what the other party would have earned if the contract had been carried out for the full period thereof. The court said, page 214:

> "No decision is cited which so holds. It seems reasonable to hold, however, that there could be no recovery, other than for nominal damages for breach of a contract which was subject to cancellation by either party upon 5 days' notice, and that in the case at bar the plaintiff could not, by reason of the defendant's breach, acquire rights greater than those which the contract gave it. . . . We are of the opinion that, upon the pleadings and proof in the present case, the plaintiff could recover from the defendant no more than nominal damages."

Cline v. Smith, 96 Cal.App. 697 (1929), concerned a contract creating an agency for the sale of tires and tubes delivered to the agent on consignment, which contract contained a provision to the effect that "either party may terminate this contract at any time by giving to the other party sixty days' notice of its intention so to do." The trial court had instructed the jury that if the defendant and cross-complainant was entitled to recover for injury to his business, they might consider the fact that his contract had eight years to run. In reversing the judgment, the court said, page 702:

> " . . . Paragraph 29 gave either party the right to terminate the contract 'at any time,' by giving the required notice, and the jury, in estimating defendant's damages, if any, had no right to consider, contrary to the plain provisions of the contract, that

> it 'had eight years to run.' In view of the company's right to terminate the contract at any time on sixty days' notice, there is not sufficient evidence to warrant a judgment in favor of the cross-complainant for anything like $25,000."

Jewell v. Colonial Theater Co., 12 Cal.App. 681 (1910), involved a complaint by an actress who had been dismissed without notice, although her written contract of employment entitled her to two weeks' notice before dismissal. She was allowed to recover pay limited to the two-week period following her discharge.

In this case, of course, in view of the court's finding that Interpublic was in default, On Mark did not have to deliver the airplane. Under the authorities just cited, however, that did not relieve it of the effect of the purported exercise of the option to terminate future rental obligation. In the cases above discussed the defendant had not effectively exercised the termination provision. They were, however, held entitled to limit the plaintiff's damages to those which would be incurred in the period necessary for them to so terminate.

B. The Effect Of The Exercise Of The Option Was To Extinguish The Obligation To Pay Rent.

As illustrative of the application of the doctrine of merger to California law, appellants have already cited the case of *Sacks v. Hayes,* 146 Cal.App.2d Supp. 885 (1956).

Another case also involving a claim by a lessor that a lessee should continue to pay rent after the exercise of an option to purchase contained in the lease agreement

is *Erving v. Jas. H. Goodman & Co. Bank,* 171 Cal. 559 (1915). That case involved a lease of real and personal property (apparently an office building and its furnishings), where the lease agreement contained an option giving the lessee the right to purchase the leased property. The exercise of the option was held to defeat the interest of the assignee of the lessor's right to collect further rents.

A federal case recognizing that the doctrine of merger applies in California is *Lloyd Corporation v. Riddell,* 222 F.Supp. 587 (S.D. Cal. 1963), where the court said, page 591:

> "The early common law was unequivocal in stating that when a smaller estate and a larger estate came into the same hands, assuming no estate intervened, there was a merger of the smaller into the larger. The smaller estate was said to be annihilated or merged in the larger. See E.g. II Blackstone's Commentaries 177 (15th ed., 1809). The same general view has been accepted and followed in California, where the transaction in question took place and where the land is located. (Citing California Civil Code, Sec. 1933, and cases.) Therefore, it seems clear that the doctrine of merger applies in California. . . . "

C. The Total Rental Payable Between The Time That On Mark Offered To Return Possession Of The Plane After Repair And The Option Date Did Not Exceed $123,952.

On February 27, 1963, upon completion of the repairs, On Mark offered possession of the airplane to defendants.

Between that time and July 15, 1964, sixteen (16) rental payments of $7,747 each accrued.[6] This would total $123,952, the maximum total rental obligation upon which any damage award could be based. As hereinafter demonstrated in Part IV, however, even this sum was subject to an offset representing the value of the exercise of the option to Interpublic.

IV. THE TRIAL COURT ERRED IN REFUSING TO ALLOW THE VALUE OF THE OPTION AS AN OFFSET AGAINST ON MARK'S RECOVERY OF RENTAL PAYMENTS.

Another way the court improperly awarded damages in excess of that which would have been received by appellees had the contract been fully performed on both sides was in its failure to give Interpublic any credit for the value of the option on the option date.

The uncontradicted evidence in the form of the testimony of On Mark's president established that the aircraft was worth $125,000 at the option date. [Rep. Tr. 517-518.] The option to purchase at $32,950 was therefore worth approximately $92,050. To preserve its rights in this respect Interpublic on June 30, 1964 sent a written notice to On Mark advising that it intended to exercise its option to purchase on July 15, 1964; but on July 2, 1964, On Mark sent a written reply to Interpublic, taking the position that since it considered Interpublic to be in default under the lease agreement, Interpublic had no right to exercise the option. [Clk. Tr. 130, par. 9.]

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[6] When the accident occurred on June 28, 1962, Interpublic had already paid rent due June 18, 1962. Its next rental payment was, therefore, not due until on or about March 18, 1963.

On Mark thereafter retained possession of the aircraft and, having repudiated any obligation to deliver it to Interpublic, asserted and enjoyed full rights of ownership. It was freely used in the business of On Mark and for personal travel of its principals. [Rep. Tr. 522-526.]

Appellants claim that they should have been allowed a credit for the value of the option at the time of the purported exercise. The evidence with respect to the value was uncontradicted. Mr. Denny, On Mark's president, testified that at the time the option was exercisable the market value of the aircraft was $125,000. [Rep. Tr. 517, line 18—518, line 12.] The trial court concluded, however, that appellants were not entitled to any credit for the value of the option right. [Con. L. 17, Clk. Tr. 176.][7] In this the court erred.

Section 3358 of the Civil Code of California, *supra,* operates not only to prevent recovery of rental beyond the option date, it also requires that in assessing damages credit be given for the value of all performance from which the plaintiff is excused as the result of defendant's breach. This aspect of the rule has been recognized in

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[7] It is true that the trial court held that Interpublic is entitled, if it so desires, to exercise its option, upon paying the judgment at the price of $32,950, subject to certain conditions. This, in effect, writes a new contract for the parties and would deprive appellants of all benefit of the option agreement which was negotiated. As Mr. Robert O. Denny testified [Rep. Tr. 375, lines 1-12], this type of piston engine airplane is being replaced by the jet plane and is 'becoming more and more obsolete as the state of the art develops better executive aircraft." The plane would, therefore, be worth substantially less today than it was worth in July 1964.

the leading authorities on the question of damages and is applied in the California cases.

McCormick on Damages, Section 143, page 587, makes the following statement:

> "Compensation for breach of contract aims to place the injured party in the condition he would have occupied if the contract had been fully performed. To this end the party is entitled to the value of all the benefits he would have received under the contract. If the party complaining has completely performed all the promises and conditions incumbent on him under the contract, then he recovers the full value of the benefits which he would have realized from the other's performance. If, on the other hand, the complaining party has performed none, or has completed only part, of the obligations and conditions imposed on him by the agreement, he may still recover his damages, on the theory that he is excused from the performance by the other's breach, assuming it to be sufficiently serious, *but it would be clearly unfair to award him the full value of what he would get from the other's performance. He must give credit, in striking the balance, for whatever he has been saved by being excused from performing.* So, in actions for breach of a buyer's contract, if the property has not been and will not be delivered by the seller, the seller recovers not the full price, but the price less the disposable value of the property which he retains. . . ." (Emphasis added.)

The Restatement of Contracts, Section 335, sets forth the same principle, as follows:

> "If the defendant's breach of contract saves expense to the plaintiff by discharging his duty of rendering a performance in return or by excusing him from the performance of a condition precedent, the amount of this saving is deducted from the damages that would otherwise be recoverable.
>
> *"Comment:*
>
> "a. The value of a promised performance to the promisee is not to be awarded without regard to its cost to him. If it is to come to him at no cost or if he has already paid for it in full, the performance when rendered would increase his wealth by its full value. To this expected increase he has a contract right; and in case of breach his damages are measured by the full value of the performance that was promised him. Such would be the case, therefore, if the defendant's broken contract is unilateral and wholly independent of and unconditional upon any performance by the promisee.
>
> "b. If, on the other hand, the promisee's right to the promised performance is conditional upon some expensive performance by him, or if *he is himself under a duty to render some expensive performance in exchange for that of the promisor, the latter's breach saves to the promisee the cost of the necessary performance on his part. This saving is credited to the defendant in reduction of damages."* (Emphasis added.)

In *Alderson v. Houston,* 154 Cal. 1 (1908), involving a breach of a contract to allow agents to sell certain lots of real property, it was held that the defendant owner was entitled to deduct from the contract price, in mitigation of damages, the amounts which the agents would have had to expend in the future performance of the contract and which they were excused from expending by reason of the defendant's breach and the agents' election to treat the contract as terminated.

In *Golden State Orchards v. Harter,* 93 Cal.App. 390 (1928), where a grower had failed to deliver fruit to the packing company, the latter was held entitled to the contract price, less what it would have cost to pack the fruit of the unfulfilled part of the contract. The court said the measure of damages was governed by Civil Code Section 1512, which provides, "If the performance of an obligation be prevented by the creditor, the debtor is entitled to all the benefits which he would have obtained if it had been performed by both parties." The court said, page 403:

> ". . .[T]he party who is to perform the service or do the things required of him by the contract is entitled, in such case, to receive the profits only which would accrue should there be full performance of the contract by him; or, in other words, that the party who was to do the things specified in the contract is entitled in such case to 'payment as for full performance,' less the cost which would necessarily be incurred by full performance."

For a similar holding, see *Griffith v. Welbanks & Co.,* 29 Cal.App. 238, 244 (1915).

Federal cases which have followed the rule that a person cannot recover in damages for the breach of a contract a greater amount than he would have gained had the contract been performed fully include *Avery v. The Schuman Company,* 159 F.Supp. 906 (S.D. Cal. 1958), and *Cooney v. Legg,* 34 F.Supp. 531 (S.D. Cal. 1940).

The applicability of these principles to the instant case is obvious. Defendants' breach of the lease agreement by the nonpayment of rent from the time On Mark offered to restore possession of the plane "excused" On Mark from the obligation to deliver the airplane then worth $125,000 for $32,950. It was only Interpublic's breach that saved On Mark the necessity of this "expensive performance in exchange." Manifestly, the effect of the rule is that "this saving is credited to the defendant in reduction of damages."

V. APPELLEE, SECURITY BANK, ACQUIRED NO RIGHTS IN EXCESS OF THOSE OF ON MARK, ITS ASSIGNOR.

The court held that appellee Security Bank was entitled to judgment for $118,857.10, with interest, being that part of the $201,422.00 accrued rent found due to On Mark necessary to satisfy the unpaid portion of On Mark's note to the Bank. If On Mark is in fact entitled to $201,422.00, there is no problem presented by this portion of the judgment. It is, however, heretofore demonstrated that no such amount is recoverable by On Mark on account of such rent.

When consideration is given to the fact that the option was in fact exercisable on July 15, 1964, and due credit

given for the exercise of the option on that date, it is clear that On Mark would be fully compensated by its taking dominion of the airplane upon repudiation of the option and being awarded judgment in the sum of approximately $31,902 ($123,952 less $92,050). The judgment in favor of the Bank for any greater sum, therefore, cannot be sustained unless it has rights against Interpublic which are independent of and in excess of those of its assignor, On Mark, and which prevent exercise of the option.

The only basis upon which the Bank could have any such rights is Plaintiff's Exhibit 9, the Receipt and Consent to Assignment, which the court held was a binding and enforceable agreement supported by legal consideration which obligated Interpublic not to "terminate" the lease. Plaintiff's Exhibit 9, however, did not purport to prevent extinguishment of the lease by exercise of the option, and if it could be so construed it would be without consideration.

A. The "Receipt and Consent to Assignment" Does Not Purport To Give The Bank Any Rights To Collect Rents Which Would Survive Exercise Of The Option.

The court held that Exhibit 9 was a binding and enforceable agreement on the part of Interpublic not to "terminate" the lease without the consent of Security Bank. [Con. L. 11, Clk. Tr. 175.] There was no occasion for the court to state what this might mean in relation to an extinguishment of the lease and rental obligation by the exercise of the option, because the court did not find the option exercisable at a time which would

result in reducing the rent to a sum less than the balance payable on the note.

To sustain a judgment for appellee Bank for more than the $31,902, which as herein demonstrated is the maximum On Mark is entitled to recover, Exhibit 9 must be construed as obligating Interpublic not to extinguish the lease by exercise of the option. Such an interpretation, however, simply cannot be indulged, because it would be directly contrary to the express language of Exhibit 9. That language clearly shows that the Bank was fully advised of the existence of the option and that its exercise was permitted.

The assignment was not simply an assignment of the right to receive rent. It included, as well, the right to receive "the proceeds of that certain Option to Purchase Aircraft dated July 10, 1959, executed by said assignor and said lessee." [Pltf's Ex. 9.] Accordingly, the Receipt and Consent to Assignment executed by Interpublic, Plaintiff's Exhibit 9, provides that Interpublic "will pay directly to assignee . . . all rentals and other moneys payable or to become payable by the undersigned to assignor under the provisions of the Lease referred to therein, *and under the provisions of that certain Option to Purchase Aircraft dated July 10, 1959, executed by said assignor and the undersigned.*" (Emphasis added.)

No moneys would be payable pursuant to the provisions of the option unless the option were exercised. Exhibit 9, therefore, certainly did not preclude exercise of the option. It merely provided that in the event the option was exercised, the Bank would reserve the proceeds of such exercise as security for the repayment of the note.

The covenant on the part of Interpublic not to "terminate" could not, therefore, possibly refer to any extinguishment of the lease which might result from the exercise of the option and the payment of the option price to appellee Bank.

In addition and apart from the fact that Exhibit 9 called for the option price to be paid to the Bank, the rule is that the assignee of a lessor who takes the assignment of the rents with knowledge of an outstanding option cannot prevent the extinguishment of the rental obligation by the exercise of the option. In *Erving v. Jas. H. Goodman & Co. Bank,* 171 Cal. 559 (1915), the lessor of real and personal property had assigned the rents to a party who had knowledge of the fact that the lease contained a provision giving the lessee the right to purchase. The court held that the exercise of the option defeated any right of the assignee to collect further rent. The court said, at page 564:

> ". . . His right to collect rent could not be any greater than Block's [assignor's] would have been in case no assignment had been made to Carter (Civ. Code, sec. 821), and Block had parted with the fee under the purchase clause in the very lease from which Carter's claims must derive their vitality, if any they have. . . ."

Appellee Bank, as assignee of the right to receive the rents, with full knowledge of the existing option has, therefore, no greater rights than On Mark.

B. There Was No Valid Consideration Or Estoppel To Support An Independent Obligation To the Bank Under The Receipt And Consent To Assignment.

The court concluded that the Receipt and Consent to Assignment was a binding and enforceable agreement supported by legal consideration [Con.L. 11, Clk. Tr. 175], and further that since appellee Bank had released certain third-party guarantors of its loan to On Mark in reliance upon the Consent to Assignment given by Interpublic, Interpublic was estopped to deny its promise not to terminate the lease. [Con.L. 12, Clk. Tr. 175.] As heretofore demonstrated in Part A of this Section V, the Receipt and Consent to Assignment does not purport to prevent extinguishment of the rental obligation by exercise of the option, since it provides specifically that the option proceeds are to be paid to appellee Bank. If it were to be so construed, however, Exhibit 9 would fail for lack of consideration. Moreover, such lack of consideration cannot in this instance be supplied by a promissory estoppel since no estoppel can be shown.

The basis of the court's conclusion that the Receipt and Consent to Assignment created a binding and enforceable independent obligation was the claim that since the appellee Bank had released certain third-party guarantors of its loan to On Mark in reliance upon the Consent to Assignment, a promissory estoppel arose. Apart from any such promissory estoppel, Plaintiff's Exhibit 9 is patently without consideration.

The evidence did indicate that Security Bank had surrendered a prior guarantee of its loan to On Mark from others after receiving the Receipt and Consent to

Assignment. However, in his final argument at the close of the trial, counsel for the Security Bank conceded that it did not appear from the evidence offered at the trial that appellants were ever informed that the Bank had surrendered a prior guarantee of the loan from Messrs. Denny and Doheny at the time Interpublic executed the Consent to Assignment. [Rep. Tr. 1752, line 20-1753, line 8.]

It is a well established principle that the surrendering or foregoing of a legal right constitutes a sufficient consideration for a contract only if the minds of the parties meet on the relinquishment of the right as a consideration. 12 Cal.Jur.2d 227. Since Interpublic never was given any notice of the Security Bank's release of the third-party guarantors, it follows that such release by the Bank cannot be effective as consideration to make the consent to assignment a binding agreement.

This principle of law has been expressly approved in a number of California cases. *Williams v. Hasshagen,* 166 Cal. 386 (1913), is squarely in point. This was a suit on a promissory note in which the defendant pleaded want of consideration. The plaintiff offered testimony that at the time the defendant executed her note to the bank, the bank had cancelled four previously outstanding promissory notes signed by officers of the bank. However, defendant testified that she had no knowledge of this fact. In upholding a judgment for the defendant, the court said, at page 390:

> " . . . Of course the cancellation of the old notes would not amount to a consideration, if Mrs. Hasshagen knew nothing about them — and she swore

> that she was ignorant of their very existence. The minds of the parties to a contract must meet before there may be any such consideration. . . . "

In the case of *Simmons v. California Institute of Technology,* 34 Cal.2d 264 (1949), the California Supreme Court made the following statement, at page 272:

> "But the consideration for a promise must be an act or a return promise, bargained for and given in exchange for the promise. (Citations.) In the words of section 75 of the Restatement of Contracts (com. b): 'Consideration must actually be bargained for as the exchange for the promise . . . The existence or non-existence of a bargain where something has been parted with by the promisee or received by the promisor depends upon the manifested intention of the parties . . . The fact that the promisee relies on the promise to his injury, or the promisor gains some advantage therefrom, does not establish consideration without the element of bargain or agreed exchange.' . . . "

Insofar as the existence of a promissory estoppel is concerned, the record simply does not support the court's conclusion that the Security Bank was induced to release the prior guarantors of the loan on the strength of Interpublic's having executed the consent to assignment.

The document itself, Plaintiff's Exhibit 9, shows on its face that before Interpublic's officers affixed their signatures, they struck the language stating that the consent was given "to induce SECURITY FIRST NATIONAL BANK . . . to make to ON MARK ENGINEERING

CO. . . . the loan secured by said Assignment, and, in consideration of the making of said loan . . . "

The act of striking these words from the written consent was certainly notice to the Bank that Interpublic did not acquiesce in the Bank's attempt to manufacture some consideration where none in fact existed. It would seem highly improbable that the Bank was "induced" to release other guarantors of the loan when it knew that Interpublic had deliberately struck the language of "inducement" from the written consent.

The case of *Kelley v. Rouse,* 188 Cal.App.2d 92 (1961) involved an option for the purchase of real property which recited that it was given "for good, valuable and adequate consideration," but the court held that the optionors were not estopped to assert, as against the optionee's assignee, that no consideration was in fact given. The court took note of statements made by a real estate broker who showed the property to the assignee to the effect that there was lack of clarity in the option agreement, that there was a "possibility of problems" in its exercise, and that it might be necessary to have "a lawsuit to square the thing away." In concluding that the purchaser could not effectively contend that he had reasonably relied upon the recitals of consideration in the option, the court said, page 99:

> ". . . These warning signals negate a vacuous acceptance of the option by appellant when an inquiry would have disclosed its lack of consideration and its subsequent withdrawal. . . ."

In conclusion as to this point, it clearly appears that the alleged detriment suffered by the Security Bank was

unknown to appellants and unbargained for; moreover, that there was no reasonable reliance on the Consent to Assignment in any event, since the Bank was notified that Interpublic explicitly declined to agree that its signing of the consent was for the purpose of inducing the Bank to take any action in regard to the loan.

CONCLUSION

On the basis of the foregoing arguments, it is respectfully submitted that this Court should determine that the trial court's judgment was erroneous insofar as it was based on the conclusion that appellants' option to purchase the aircraft was not exercisable until the period commencing on January 26, 1965. Since the trial court determined its award of damages to appellees by proceeding on this erroneous premise, its judgment should be modified by reducing appellees' damages to the amount they would have received had the contract, properly construed, been fully performed on both sides.

Where the trial court's findings in a case tried without a jury are erroneous only because of a misconstruction of law, the U. S. Court of Appeals may direct the entry of a proper judgment in the lower court and thus terminate the litigation upon the merits.

28 U.S.C. § 2106;

Herzberg's, Inc. v. Ocean Accident & Guarantee Corp., Ltd., 132 F.2d 438 (8th Cir. 1943).

It should accordingly be determined that the maximum total rental obligation owing to appellee On Mark is the sum of $123,952, representing sixteen (16) rental pay-

ments of $7,747 each for the months between February 1963 and July 1964, and that this sum should be reduced by $92,050, the value of the exercise of the option to appellants, leaving a balance of $31,902. The judgment for said appellee and for appellee Bank, which has no greater rights, should be reduced to such sum.

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RODNEY K. POTTER